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## Birnbaum: Revisited and Triumphant - Blue Chip Stamps v. Manor Drug Stores

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## NOTES

### ***BIRNBAUM: REVISITED AND TRIUMPHANT— BLUE CHIP STAMPS v. MANOR DRUG STORES***

One of the most perplexing facets of the securities laws has been determining the limits of the plaintiff class under the broad anti-fraud provisions of section 10(b) of the Securities Exchange Act of 1934<sup>1</sup> and rule 10b-5<sup>2</sup> promulgated by the Securities Exchange Commission in 1942. The recent decision in *Blue Chip Stamps v. Manor Drug Stores*,<sup>3</sup> holding that only actual purchasers or sellers may maintain actions under section 10(b) and rule 10b-5 of the securities laws, is the Supreme Court's response to this complex field of litigation, marking the first time that the Court elected to squarely confront the issue of standing in securities litigation. This Note will include a brief examination of the remedial provisions within the securities laws and a discussion of *Birnbaum v. Newport Steel Corp.*,<sup>4</sup> the landmark case which is the progenitor of the law of standing in this area. This discussion will be followed by an analysis and critique of the recent *Blue Chip Stamps* decision, and concluding observations and recommendations regarding standing to sue in securities litigation.

#### SECTION 10(b), RULE 10b-5, AND THE *Birnbaum* DOCTRINE

Section 10(b) of the Securities Exchange Act of 1934<sup>5</sup> broadly proscribes the "use of any manipulative or deceptive device[s]," and to that end directs the Securities and Exchange Commission to prescribe such rules as are "necessary and appropriate." Pursuant to this author-

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1. 15 U.S.C. §78j(b) (1970). See note 5, *infra*.

2. 17 C.F.R. §240.10b-5 (1969). See note 7, *infra*.

3. 95 S. Ct. 1917 (1975).

4. 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

5. 15 U.S.C. §78j (b) (1970) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

ity, and under less than casual circumstances,<sup>6</sup> the SEC promulgated rule 10b-5<sup>7</sup> in 1942.<sup>8</sup> Unlike other sections of the securities laws,<sup>9</sup> section 10(b) did not provide express civil remedies for violation of its provisions. In 1946, the seminal case of *Kardon v. National Gypsum Corp.*,<sup>10</sup> held that a private civil action was implied from the section and the

6. The origin of the rule has been best recalled by Milton Freeman, an SEC attorney at the time of its announcement in *Conference on Codification of the Federal Securities Laws*, 22 Bus. Law. 793, 922 (1967).

7. 17 C.F.R. §240.10b-5 (1969) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ any device, scheme, or artifice to defraud,
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

8. SEC Securities Act Release No. 3220 (May 21, 1942) reads as follows:

The Securities and Exchange Commission today announced the adoption of a rule prohibiting fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to brokers or dealers. The new rule closes a loophole in the protection against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase. The text of the Commission's action follows:

The Securities and Exchange Commission, deeming it necessary for the exercise of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors so to do, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, particularly sections 10(b) and 23(A) thereof, hereby adopts the following Rule X-10b-5 . . . .

9. See, e.g., Securities Act of 1933 §§11(a), 12(2), 17(a), 15 U.S.C. §§77k(a), 771(2), 77q(a) (1970). Sections 11 and 12(2) of the 1933 Act provide civil remedies for the deceived purchaser of securities sold with the use of a misleading prospectus. If the prospectus is part of a registration statement which has become "effective" under the Act, the action is cognizable under section 11(a). If the statement has not become effective, it is cognizable under section 12(2). Section 17(a), upon which 10b-5 was largely based, renders it unlawful for "any person in the offer or sale of any security" to commit fraud by use of any of the jurisdictional means. A violation of clause (2) of section 17(a) results in liability under sections 11(a) or 12(2). There is no specific civil action provided for violation of clauses (1) or (3) of section 17(a). Additionally, section 17(a) does not provide any remedy for the defrauded seller of securities. See also 1 A. BROMBERG, *SECURITIES LAW: FRAUD* §2.1 (Supp. 1970) [hereinafter cited as BROMBERG].

10. 69 F. Supp. 512 (E.D. Pa. 1946). See also *Fishman v. Raytheon Mfg. Corp.*, 188 F.2d 783 (2d Cir. 1951), which recognized the implied remedy in favor of sellers.

rule.<sup>11</sup> Judge Kirkpatrick, however, omitted from his opinion any discussion of the limitations upon this implied civil action. Six years later, a most distinguished panel of the prestigious second circuit, in the landmark case of *Birnbaum v. Newport Steel Corp.*,<sup>12</sup> ruled that section 10(b) and rule 10b-5 of the securities laws protect only the actual purchaser or seller of securities and that the protections do not extend to fraudulent mismanagement.<sup>13</sup>

In *Birnbaum*, shareholders of Newport Steel brought a derivative and representative suit. They alleged violation of the section and the rule against defendants Feldmann, whose ownership of 40% of the outstanding common stock gave him voting control, the other directors of Newport, and the Wilport Company. Feldmann, in his official capacity as president of Newport Steel had rejected a merger offer from Follansbee Steel Corporation which "would have been highly profitable to all the stockholders of Newport."<sup>14</sup> Instead, he had sold his shares to defendant Wilport at a substantial premium—twice the existing market value of the stock. The plaintiffs, who neither purchased nor sold shares, and thus had not participated in the securities transaction, contended that defendant Feldmann had violated the rule by selling his shares at a substantial profit.<sup>15</sup>

The plaintiffs further alleged that inasmuch as the language "any person" was a general proscription against fraud, the application of rule 10b-5 was not limited to the actual purchasers or sellers of securities. This construction was supported by the rule's language "in connection with the purchase of sale or any security." If the purpose of the rule was to limit its operation to the actual purchase or sale of securities, the phrase "in connection with" would be superfluous.<sup>16</sup>

In the formulation of its opinion, the court of appeals examined the scheme of SEC regulation and the underlying purpose for the promulgation of the rule. The court noted that prior to the adoption of the rule the only prohibitions against fraud committed by the purchaser of securities found in section 17(a) of the 1933 Act<sup>17</sup> and section 15(c) of the

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11. 69 F. Supp. at 514. "[I]n view of the general purpose of the Act, the mere omission of an express provision for civil liability is not sufficient to negative what the general law implies."

12. 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). The three judges sitting in review were Augustus Hand, who wrote the opinion, Learned Hand, and Chief Judge Swan.

13. See notes 18-21 and accompanying text *infra*.

14. 193 F.2d at 462.

15. *Id.*

16. *Id.* at 463.

17. 15 U.S.C. §17q(a) (1970). See note 9, *supra*.

1934 Act<sup>18</sup> were against a broker or a dealer. Additionally, the SEC, in its adoption of rule 10b-5, published a statement indicating in part that the rule was designed to "close . . . [this] loophole" by prohibiting fraud in connection with the purchase of securities.<sup>19</sup> The court concluded "that the Commission was attempting only to make the same prohibitions contained in Section 17(a) of the 1933 Act applicable to purchasers as well as to sellers."<sup>20</sup> Rejecting plaintiffs' contention that this interpretation was too narrow, the court presented what has come to be known as the *Birnbaum* doctrine: ". . . that Section [10(b)] was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10b-5 extended protection only to the defrauded purchaser or seller."<sup>21</sup>

For the past twenty years the federal judiciary has struggled with these substantive (no fraudulent mismanagement protection) and procedural (purchaser or seller requirement) limitations. It is clear that at this time the substantive limitation has all but disappeared as a stumbling block to litigation under the section and the rule.<sup>22</sup> The *Birnbaum* procedural limitation, on the other hand, has experienced a more checkered history and has even caused one court to comment: "*Birnbaum* has been shot at by expert marksmen . . . . Bloody but unbowed, *Birnbaum* still stands."<sup>23</sup>

The limitations initially advanced in *Birnbaum* were by no means exclusive. Since the recognition of an implied remedy in 1946, substantive limitations borrowed from the law of torts, including materiality,<sup>24</sup> reasonable reliance,<sup>25</sup> privity,<sup>26</sup> and causation<sup>27</sup> have become necessary elements of the plaintiff's cause of action. As was the case with the strict purchaser-seller requirements prior to *Blue Chip Stamps*, however, these limitations have been significantly relaxed.<sup>28</sup> In fact, in an attempt

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18. 15 U.S.C. §78o(c) (1970).

19. 193 F.2d at 463. See note 8, *supra*.

20. 193 F.2d at 463.

21. *Id.* at 464.

22. See, e.g., Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971). "Since there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under §10(b), whatever might be available as a remedy under state law." *Id.* at 12.

23. *Rekant v. Desser*, 425 F.2d 872, 877 (5th Cir. 1970).

24. See, e.g., *List v. Fashion Park, Inc.*, 340 F.2d 457 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965).

25. See, e.g., *Rogen v. Ilikon Corp.*, 361 F.2d 260 (1st Cir. 1966).

26. See, e.g., *Joseph v. Farnsworth Radio & TV Corp.*, 198 F.2d 883 (2d Cir. 1952).

27. See, e.g., *Barnett v. Anaconda Co.*, 238 F. Supp. 766 (S.D.N.Y. 1965).

28. See, e.g., *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

to give effect to the congressional purpose evinced in the securities laws and still delimit the contours of the cause of action, the courts have tended to use these limitations interchangeably. That is, as the substantive limitations became less important in a particular context, the purchaser-seller requirement assumed added importance. Conversely, in those cases where the plaintiff was not an actual purchaser or seller, the elements of causation, materiality and reliance were thrust to the fore of judicial examination.<sup>29</sup>

For the most part, the litigation brought under the section and the rule during the past three decades has demonstrated judicial receptiveness to an entire spectrum of 10b-5 claims. This receptivity has not passed without a continuous reassessment of the *Birnbaum* purchaser-seller limitation. As one article recently noted:

the subsequent decline in "face-to-face" dealings between purchasers and sellers, the complexity of securities transactions, and the increasing sophistication of fraudulent schemes have required courts . . . to expand the definitions of purchase and sale, as well as the class of persons falling into the category of purchasers and sellers.<sup>30</sup>

In some instances, several courts, including the seventh circuit, have rejected the purchaser-seller doctrine in its entirety.<sup>31</sup> Since there was a conflict among the circuits<sup>32</sup> and an absence of any authoritative guidelines from the Supreme Court regarding the scope of actions brought under section 10(b) and rule 10b-5,<sup>33</sup> the Supreme Court granted

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29. See Boone & McGowan, *Standing to Sue Under SEC Rule 10b-5*, 49 TEXAS L. REV. 617, 619-30 (1971) [hereinafter cited as Boone & McGowan].

30. Froelich & Spiegel, *Standing of Federal Securities Plaintiffs—Which Way the Trend*, 24 DEPAUL L. REV. 510, 514 (1975) [hereinafter cited as Froelich & Spiegel].

31. See, e.g., *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654 (7th Cir. 1973), cert. denied, 416 U.S. 960 (1974); *Vincent v. Moench*, 473 F.2d 430 (10th Cir. 1973); *Young v. Seaboard Corp.*, 360 F. Supp. 490 (D. Utah 1973).

32. See note 31, *supra*. For two articles describing the decision-making process under the section and the rule, see Cohen, *The Development of Rule 10b-5*, 23 BUS. LAW. 593 (1968) ("ad hoc"); Marsh, *What Lies Ahead Under Rule 10b-5?* 24 BUS. LAW. 69 (1968) ("chaotic").

33. The history of Supreme Court review of 10(b) and 10b-5 may be best characterized as sparse. The Court's first occasion to interpret these provisions was in *SEC v. National Sec. Inc.*, 393 U.S. 453 (1969), some twenty-seven years following the promulgation of 10b-5. No doubt, much of the confusion in this area of securities litigation may be attributed to those instances in which certiorari was denied, resulting in an absence of guidance from the Court. See, e.g., *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654 (7th Cir. 1973), cert. denied, 416 U.S. 960 (1974); *Dudley v. Southeastern Factor & Fin. Corp.*, 446 F.2d 303 (5th Cir.), cert. denied, 404 U.S. 858 (1971); *Kahan v. Rosentiel*, 424 F.2d 161 (3rd Cir.), cert. denied, 398 U.S. 950 (1970); *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), cert. denied, 400 U.S. 822 (1970); *Dahso v. Sques-*

certiorari to *Blue Chip Stamps v. Manor Drug Store*.<sup>34</sup> The Court thereby agreed to review the status of the purchaser-seller limitation for the first time since *Birnbaum* was decided.<sup>35</sup>

#### HISTORY OF THE CASE<sup>36</sup>

In 1963, the United States instituted a civil action charging the Blue Chip Stamps Co. and participating retailers for violation of the Sherman Act. This litigation was terminated by entry of a consent decree in 1967.<sup>37</sup> Some of the participating retailers who used Blue Chip Stamps to stimulate patronage in their business owned 90% of the Blue Chip Stamps stock. Other retailers who used Blue Chip Stamps in their business but owned no stock, appeared before the court as amici curiae. They requested that any decree recognize their entitlement to an equitable interest in the Blue Chip Stamps stock.

The consent decree, which reflected these various claims and contentions,<sup>38</sup> resulted in an offering of 55% of the common stock to retail users who were not stockholders of the old company. The shares were to be offered on a prorata basis determined by the quantity of stamps issued to each of these non-stockholding users during a designated period. The offering was to be made in units consisting of three shares of common stock plus a \$100 debenture at the price of \$101. Since each unit had a reasonable market value of \$315, this offer was intended as a bargain.

Pursuant to provisions of the consent decree and in compliance with

hanna Corp., 380 F.2d 262 (7th Cir.), *cert. denied*, 389 U.S. 977 (1967); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

34. 419 U.S. 992 (1974).

35. Similarly, the Court did not have an occasion to deal with the decision of *Kardon v. National Gypsum Corp.*, 69 F. Supp. 512 (E.D. Pa. 1946), *see notes 7-8 and accompanying text supra*, until more than twenty years later, at which time, the implied private right of action was acknowledged by a mere footnote. *See Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971). Seven years prior to that decision, however, the Court recognized that private actions were a "necessary supplement to Commission action." *J. I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964).

36. The facts were taken from the opinion of the district court and the Court of Appeals for the Ninth Circuit. *See Manor Drug Stores v. Blue Chip Stamps*, 339 F. Supp. 35 (C.D. Cal. 1971), *rev'd*, 492 F.2d 136 (9th Cir. 1973), *appeal rev'd*, 95 S. Ct. 1917 (1975).

37. *United States v. Blue Chip Stamps Co.*, 272 F. Supp. 432 (C.D. Cal. 1967), *aff'd sub nom. Thrifty Shoppers Scrip Co. v. United States*, 389 U.S. 580 (1968).

38. The consent decree provided in section V:

Blue Chip is ordered and directed to present to the Court . . . a plan for reorganization of Blue Chip Stamp Co. . . . Upon approval of the plan by the Court, Blue Chip shall make bona fide and diligent efforts to reorganize the company pursuant to said plan . . . .

Subsequently, a plan incorporating this order was submitted and approved.

applicable securities laws governing a public issue of securities, Blue Chip Stamps prepared a prospectus. Plaintiffs, however, alleged that it "was calculated to mislead and dissuade users not knowledgeable of the true value of said shares from purchasing said shares."<sup>39</sup> Specifically, the prospectus repeatedly emphasized "Items of Special Interest" which would have an adverse effect on the value of the offered stock. One such item, for example, concerned the pendency of claims worth 29 million dollars against the company; claims which were actually settled for less than one million dollars. Significantly, these "Items of Special Interest" were deleted from the prospectus used in the subsequent public offering.<sup>40</sup>

The basis of the 10b-5 cause of action was that the defendant intentionally misled plaintiffs as to the true value of the stock, thereby inducing them not to purchase the stock, and injuring them in an amount equal to the difference between the offering price of the units and the fair market value.<sup>41</sup> The plaintiffs' case thus resembled the "aborted purchaser-seller" exception to the *Birnbaum* doctrine.<sup>42</sup>

The district court, relying upon section 28(a) of the Exchange Act,<sup>43</sup> dismissed the complaint by determining that since the plaintiffs neither purchased nor sold securities, they suffered no actual damages.<sup>44</sup> The

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39. 492 F.2d at 139.

40. *Id.* at 139-40.

41. *Id.* at 140. The plaintiff, Manor Drug Stores, made the following additional allegations to its key 10(b) and 10b-5 complaint: (a) the misrepresentations of the directors and offering shareholders were a violation of section 12 of the 1933 Act, 15 U.S.C. §771 (1970); (b) plaintiff is a third party beneficiary under the consent decree and the offering directors and shareholders actions breached their duty to plaintiff for which they are liable. The district court dismissed the section 12 claim on the basis of a failure to purchase and lack of privity. It also dismissed the beneficiary claim inasmuch as a non-party to an antitrust decree lacks standing to enforce the same. In the court of appeals and the Supreme Court only the 10(b) and 10b-5 claims were specifically pressed. 339 F. Supp. 35, 38-39 (C.D. Cal. 1971).

42. For an explanation of the "aborted purchaser-seller" exception see note 125, *infra*.

43. Securities Exchange Act of 1934, §28(a), 15 U.S.C. §78bb(a) (1970) provides in part: The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.

See, e.g., *Wolf v. Frank*, 477 F.2d 467 (5th Cir.), *cert. denied*, 414 U.S. 975 (1973); *Green V. Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969). *But see* *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972); *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968). See notes 71-73 and accompanying text *infra*.

44. 339 F. Supp. at 40.



Court of Appeals for the Ninth Circuit, in a divided opinion, reversed, finding an exception to the *Birnbaum* requirement in that compliance with the antitrust decree served the same function as a securities purchase or sales contract. There thus existed a specific identifiable group with the requisite causation and an objective basis for determination of loss.<sup>45</sup>

The Supreme Court, in rejecting both the arguments of the SEC<sup>46</sup> and of plaintiff-respondents, Manor Drug Stores, held that a private damage action under rule 10b-5 is limited to actual purchasers or sellers of securities. Consequently, the *Birnbaum* doctrine barred maintenance of a 10b-5 action by the plaintiffs.<sup>47</sup> In an opinion<sup>48</sup> described by the dissent<sup>49</sup> as "exhibiting a preternatural solicitousness for corporate well-being and a seeming callousness toward the investing public,"<sup>50</sup> as well as "mire[d] in speculation and conjecture not usually seen in its opinions,"<sup>51</sup> the majority enumerated several factors in support of its decision: legislative history of the securities laws, policy considerations, and two decades of judicial precedent.<sup>52</sup>

#### LEGISLATIVE HISTORY

Reliance upon the legislative and administrative history of section 10(b) and rule 10b-5 is inapposite.<sup>53</sup> Even the *Blue Chip Stamps* major-

45. 492 F.2d at 142.

46. The SEC appeared before the Supreme Court as amicus curiae and urged abandonment of the strict purchaser-seller requirement in favor of a more liberal causation-injury approach. Brief for SEC as Amicus Curiae, at 20-32, *Blue Chip Stamps v. Manor Drug Stores*, 95 S. Ct. 1917 (1975). For a discussion of the causation-injury approach, see notes 118-20 and accompanying text *infra*.

47. 95 S. Ct. at 1923.

48. The majority opinion, written by Justice Rehnquist, was joined by Chief Justice Burger, and Justices Stewart, White, Marshall and Powell. Justice Powell also filed a concurring opinion, in which Stewart and Marshall joined. *Id.* at 1935.

49. Justice Blackmun filed the dissenting opinion, in which Justices Douglas and Brennan joined. *Id.* at 1937.

50. *Id.* at 1938.

51. *Id.* at 1941.

52. The dissenting opinion describes these premises as "three blunt chisels" with which to carve the *Birnbaum* doctrine into stone. *Id.* at 1937 (Blackmun, J., dissenting).

53. The legislative and administrative history of the section and the rule have been described in various ways. For example, Bromberg has stated:

Section 10(b) was one of the least controversial parts of the 1934 Act . . . . Of nearly a thousand pages of hearings in the House, the combined references to § 10(b) would scarcely fill a page. Much the same is true in the Senate. The several committee Reports . . . add little or nothing to the evidence on intent . . . . The floor debates are no more enlightening.

ity recognized that the available extrinsic evidence was "not conclusive."<sup>54</sup> The Court further noted that it "would be disingenuous to suggest that either Congress in 1934 or the Securities and Exchange Commission in 1942 foreordained the present state of the law with respect to 10b-5."<sup>55</sup> Nevertheless, the reaffirmance of *Birnbaum* has the effect of confining the state of 10b-5 development to the level originally contemplated by the Commission in 1942.<sup>56</sup> This insistence on the purchaser-seller limitation is inconsistent with the broad remedial scope of the securities laws and of the Exchange Act of 1934 in particular.<sup>57</sup>

The use of the language "any person" in both the section and the rule supports the conclusion that neither plaintiff nor defendant is required to be a purchaser or seller.<sup>58</sup> The fact that courts have held that the defendant need not be a purchaser or seller<sup>59</sup> emphasizes that the purchaser-seller doctrine is directed primarily to the question of plaintiff's standing to maintain an action.<sup>60</sup> Nor is the phrase "in connection

1 BROMBERG § 2.2, at 330-31 (Supp. 1970). Similarly, Whittaker has described the history as "inconclusive." Whittaker, *The Birnbaum Doctrine: An Assessment*, 23 ALA. L. REV. 543, 584 (1971). Finally, one student has stated: "To the extent that the legislative history shows anything meaningful, then, it does not support the Birnbaum construction of Rule 10b-5, but rather suggests that the section was to protect all investors." Comment, *The Purchaser-Seller Requirement of Rule 10b-5 Reevaluated*, 44 U. COLO. L. REV. 151, 154 (1972). See also Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?* 57 NW. U. L. REV. 627, 642-60 (1963).

54. 95 S. Ct. at 1924.

55. *Id.* at 1926.

56. See notes 19-21 and accompanying text *supra*.

57. One commentator has remarked:

Arguably the words "in connection" in 10b-5 would not have been necessary if only purchasers and sellers of securities were to be protected. Instead, a broad definition of the protected class would be consistent with the draftsmen's intent to cover not only fraud as to the "investment value" of the securities but also novel or atypical methods of fraud.

Boone & McGowan, *supra* note 29, at 621-22. See also Ruder, *Current Developments in the Federal Law of Corporate Fiduciary Relations—Standing to Sue Under Rule 10b-5*, 26 BUS. LAW. 1289 (1971), who feels that the result in *Birnbaum* was unnecessary because the words "directly or indirectly," found in both 10(b) and 10b-5 "give sufficient latitude to a court wishing to allow suits by shareholders who still hold their stock." *Id.* at 1294.

58. See generally Comment, *The Purchaser-Seller Rule: An Archaic Tool For Determining Standing Under Rule 10b-5*, 56 GEO. L.J. 1177 (1968); Note, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 CORNELL L. REV. 684 (1968).

59. See, e.g., *Heit v. Weitzen*, 402 F.2d 909 (2d Cir. 1968), holding that there was no necessity for the defendant to be trading contemporaneously in securities in order to be held liable under rule 10b-5.

60. It should be further noted that nothing in the section or the rule focuses upon the plaintiff; in fact, the "any person" phrase in this context refers exclusively to the defendants. See also Note, *Standing to Sue in 10b-5 Actions: Eason v. GMAC and Its Impact on the Birnbaum Doctrine*, 49 NOTRE DAME LAW. 1131, 1140-42 (1974).

with a purchase or sale of any security" conclusive evidence of a purchaser-seller requirement. On the contrary, this language requires that there be a nexus between the proscribed conduct and a securities transaction.<sup>61</sup> This argument is buttressed by the language "directly or indirectly," found in both the section and the rule.<sup>62</sup>

After surveying the remedies provided by the securities statutes, the Court in *Blue Chip Stamps*, concluded that "[w]hen Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble doing so expressly."<sup>63</sup> This statement seems to be begging the question since it is equally clear that if Congress had wished to impose a purchaser-seller limitation in section 10b (or the SEC in rule 10b-5), it could have done so expressly.

Although neither the legislative history of section 10(b) nor the administrative history of rule 10b-5 discloses an intent to create a private remedy, two decades of judicial decisions have not only created a private remedy, but have also expanded the class of 10b-5 plaintiffs.<sup>64</sup> Considering this expansion of the remedy and the repeated amicus curiae appearances by the SEC calling for the abandonment of the *Birnbaum* limitation<sup>65</sup> it is of little comfort to the investing public that the

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One commentator has thus concluded that section 10(b) lacks the foundation upon which the purchaser-seller limitation may be engrafted. An analysis of that limitation should be based upon the section because it is inappropriate for the courts to conclude that the limitation is derived by resort to the rule placed in juxtaposition to the 1942 release, *see note 8, supra*. The writer buttresses this conclusion by noting that the Commission is not bound to its 1942 interpretation of the rule; nor has it exhausted its rule-making authority under section 10(b) with the promulgation of rule 10b-5. Comment, *Dumping Birnbaum to Force Analysis of the Standing Requirement under Rule 10b-5—Eason v. GMAC*, 6 LOYOLA (CHI.) L.J. 230, 234 (1975). *See also* 3 L. LOSS, SECURITIES REGULATION, 1469 n.87 (1961). This approach finds further support in the fact that no case, to date, has declared whether the *Birnbaum* standing requirement is compelled by the section or the rule, or both.

For further discussion of the requirements regarding standing, *see Flast v. Cohen*, 392 U.S. 83 (1968) (constitutional requirements); *Association of Data Processing Serv. Org. Inc. v. Camp*, 397 U.S. 150 (1970) (non-constitutional requirements). *See also* Note, *Standing to Sue in 10b-5 Actions: Eason v. GMAC and Its Impact on the Birnbaum Doctrine*, 49 NOTRE DAME LAW. 1131, 1140-42 (1974).

61. *See* Whittaker, *supra* note 53, at 583.

62. *See* note 57, *supra*.

63. 95 S. Ct. at 1925.

64. *See* note 125, *infra*.

65. The Securities and Exchange Commission, rather than promulgate further guidelines for the conduct of litigation under 10b-5, has contented itself to file amicus curiae briefs, leaving development of the section and the rule to the courts. Some of the cases in which the Commission has appeared as amicus curiae are: *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515 (6th Cir. 1973); *Mount Clemens Indus. v. Bell*, 464 F.2d 339 (9th Cir. 1972);

Supreme Court in *Blue Chip Stamps* has chosen to preserve a doctrine ill-suited to deter the fraud which arises in an economic environment of complex corporate transactions.<sup>66</sup>

#### POLICY CONSIDERATIONS

Finding inconclusive support for the *Birnbaum* doctrine in legislative and administrative history, the Court turned to policy considerations. Although consideration of policy accounts for the bulk of the majority opinion, it comprises the weakest link in support of the purchaser-seller limitation.<sup>67</sup>

The Supreme Court adverts to a fear of "conjectural and speculative recovery"<sup>68</sup> by plaintiffs who are neither purchasers nor sellers, who base their damages upon a "subjective hypothesis" of the number of shares they would have purchased or sold but for the fraud. In support of this premise the Court cites section 28(a) of the 1934 Act<sup>69</sup> which limits recovery in private damage actions to the actual damages suffered. Although case law under this section has repeatedly limited recovery to a measure of out-of-pocket damages,<sup>70</sup> the cases of *Affiliated Ute Citizens of Utah v. United States*<sup>71</sup> and *Myzel v. Fields*<sup>72</sup> demonstrate that this is by no means an ironclad rule. As these two cases indicate, where there

*Levine v. Seilon, Inc.*, 439 F.2d 328 (2d Cir. 1971); *Iroquois Indus. Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969); *Vine v. Beneficial Fin. Co.*, 374 F.2d 627 (2d Cir. 1967).

66. The court indicated that any revocation of the purchaser-seller requirement should be made by Congress. 95 S. Ct. at 1932.

67. See *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654 (7th Cir. 1973), in which the seventh circuit, in declaring that *Birnbaum* was no longer applicable law for the circuit, found similar policy arguments to be largely speculative and unpersuasive. *Id.* at 660-61.

68. 95 S. Ct. at 1925.

69. 15 U.S.C. §78bb(a) (1970). See note 43, *supra*.

70. See, e.g., *Wolf v. Frank*, 477 F.2d 467 (5th Cir. 1973).

71. 406 U.S. 128 (1972). The Court found that the actual sale prices of stock sold pursuant to fraudulent inducements were an insufficient basis for determining the damages incurred. Instead, the Court took into account numerous factors, including the presence of unknown quantities of mineral deposits upon Indian lands and the existence of unliquidated claims against the United States, in reaching a valuation per share upon which "reasonable inferences may be drawn" and which has "sufficient support in the record." *Id.* at 155-56.

72. 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968). The court held that the effect of section 28 (a) was to limit punitive damages that were otherwise available under state remedies. It permitted a recovery of a sum equal in value to the stock, which plaintiff was fraudulently induced to sell, if the jury found that with full disclosure of the facts, he would have retained his stock until the higher price gained by the wrongdoer was attained. *Id.* at 745.

is sufficient evidence upon which the finder of fact may make a reasonable inference as to the loss sustained, the proviso limiting recovery to "actual damages" is not violated.<sup>73</sup>

The factual circumstances of *Blue Chip Stamps* disclosed sufficient evidence from which such reasonable inferences may be made. The court of appeals noted:

The consent decree required defendant-appellees to offer particular securities to a specific, identifiable group of non-stockholding retail users of Blue Chip Stamps, including plaintiff-appellant, and plaintiff-appellant had a right to buy those securities at a fixed price and in a fixed amount. The complaint alleges an objective measure of the amount of loss based on subsequent sales by the defendants.<sup>74</sup>

The fact that the consent decree provisions were a bargain<sup>75</sup> indicates an ability to acquire the shares offered. It is reasonable to infer that the plaintiff-appellees would have purchased the amount to which they were entitled.<sup>76</sup> In short, there was no speculative basis for recovery here.

The holding in *Blue Chip Stamps* is indicative of the failure of the purchaser-seller limitation to adequately fulfill the remedial and prophylactic nature of the securities laws. By the Court's own admission, the *Birnbaum* rule "unreasonably prevents some deserving plaintiffs from recovering damages which have in fact been caused by violation of rule 10b-5 . . . and to that extent is undesirable."<sup>77</sup> Nevertheless, the Court found countering advantages to the maintenance of the *Birnbaum* rule in policy considerations which, not surprisingly, "are more difficult to articulate than . . . the disadvantages."<sup>78</sup>

The Court speaks of "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general."<sup>79</sup> This reliance upon "vexatiousness" is misplaced. For example, section 11(e) of the 1933 Act,<sup>80</sup> was cited by the Court as evidence of congressional concern for limiting "vexatious" litigation. Section 11(e), however, was

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73. Professor Bromberg has noted that very few 10b-5 cases have been decided upon the merits. Thus, there is relatively little authority on relief, and section 28(a), which limits recovery to "actual damages," "offers little help in determining what actual damages are." 3 BROMBERG §9.1 (1967). See also *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.), cert. denied, 382 U.S. 879 (1965).

74. 492 F.2d at 142.

75. See notes 36-38 and accompanying text *supra*.

76. 492 F.2d at 142.

77. 95 S. Ct. at 1926, 1929.

78. *Id.* at 1927.

79. *Id.*

80. 15 U.S.C. §77k(e) (1970). This section provides for a court to require a plaintiff to pay costs if the court determines that the suit brought by plaintiff was without merit.

properly designed to control vexatious litigation under the 1933 Act, quite apart from any consideration of the plaintiff class under 10(b) or 10b-5 of the 1934 Act.<sup>81</sup> Moreover, even without a specific statutory provision, the federal district courts are eminently capable of discerning "strike" or nuisance suits from meritorious claims. In dismissing the complaint in *Christophides v. Porco*,<sup>82</sup> the court noted:

The complaint herein is representative of a growing number of 10b-5 suits brought in this Court on unique, esoteric and implausible legal theories. Innovation is not to be discouraged, nor the imaginative instinct dulled. However, claims cloaked in a tissue of confusion devoid of federal jurisdiction or legal merit, impede rather than foster progress in the field of investor protection.<sup>83</sup>

The Court fears that elimination of the *Birnbaum* doctrine will lead to "the potential for possible abuse of the liberal discovery provisions of the federal rules,"<sup>84</sup> resulting in a concomitant disruption of normal business activities. Nevertheless, the anxiety expressed by the majority opinion in this regard is subject to relief by way of Federal Rule of Civil Procedure 26(c)<sup>85</sup> which provides for the issuance of "protective orders" during discovery proceedings.<sup>86</sup>

81. *Cf. McClure v. Borne Chem. Co.*, 292 F.2d 824 (3d Cir. 1961), which rejected the concept of imposing by analogy the restrictions and requirements found in other provisions of the securities laws. Thus, the court held that the various civil liability provisions of the securities laws did not manifest a uniform policy favoring the posting of a security for expenses, and did not imply such a limitation in 10(b) actions. *Id.* at 836-37. *See also* *Ellis v. Carter*, 291 F.2d 270, 272-74 (9th Cir. 1961). *See generally* 1 BROMBERG §2.5(2) (Supp. 1968).

82. 289 F. Supp. 403 (S.D.N.Y. 1968).

83. *Id.* at 406.

84. 95 S. Ct. at 1928.

85. FED. R. CIV. P. 26(c) provides:

Upon motion by a party or by the person from whom discovery is sought, and for good cause shown, the court in which the action is pending or alternatively, on matters relating to a deposition, the court in the district where the deposition is to be taken may make any order which justice requires to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense . . . .

86. In a different context, one wonders whether this new found concern for the abuse of discovery proceedings will spell an end to the enforcement of the antitrust laws which have now been enforced for more than eight decades and stand as a commitment to the principle of free competition. *See, e.g.*, the Sherman Antitrust Act, 15 U.S.C. §§1-2 (1970); the Robinson-Patman Act, 15 U.S.C. § 13 (1970). This writer cannot imagine a more pervasive and in depth use of discovery techniques than those which accompany charges of engaging in "conspiracy" or "reciprocity" under the Sherman Act. *See, e.g.*, *United States v. Socony-Vacuum Oil Co., Inc.*, 310 U.S. 150 (1940), (conspiracy); *United States v. General Dynamics*, 258 F. Supp. 36 (S.D.N.Y. 1966), (reciprocity). It is conceiva-

The Court's "vexatiousness" argument also relies on the theory that most companies will opt for a settlement rather than endure drawn out litigation that involves disruption of normal business activities and the hazards of oral proof.<sup>87</sup> This purported fear of oral proof is unfounded because the courts have the capacity to develop rules allocating the burden of corroboration to the plaintiff.<sup>88</sup> Similarly, to attach as sole motive to those companies who settle without trial the desire to avoid nuisance suits does not comport with reality. For example, Professor Ruder has commented that many settlements are motivated by a defendant's fear of substantial damage judgments following a trial on the merits.<sup>89</sup> An invalid claim, on the other hand, would not elicit such fears.

Finally, the majority fears that abandonment of the *Birnbaum* rule will result in a recovery based largely on speculation, compelled by the plaintiff's subjective hypothesis as to the extent of his financial loss.<sup>90</sup> This would necessitate the "fashioning of unique rules of corroboration and damages" for the purpose of correcting the alleged dangers of an expanded class of plaintiffs.<sup>91</sup> Yet, an important function of courts is to develop such rules. In the case of *Gertz v. Robert Welch, Inc.*,<sup>92</sup> for example, the Supreme Court has shown no aversion to refashioning unique rules of damages, even if this entails overturning damage rules which have existed for two centuries.

The Court's misplaced fear of speculative recovery, vexatious litigation and abuse of discovery detracts from their thorough consideration of the substantive issues which lie at the heart of 10(b) and 10b-5 actions, namely, whether the plaintiff sustained a loss as a consequence of fraud in connection with the purchase or sale of a security.

#### TWO DECADES OF JUDICIAL PRECEDENT

The majority opinion in *Blue Chip Stamps*, in analyzing the case law decided since 1952, curtly observed: "virtually all lower federal courts

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ble that this type of proceeding would be in jeopardy and is probably what prompted the dissent to conclude that "acceptance of this decisional route in this case may well come back to haunt us elsewhere before long." 95 S. Ct. at 1942 (Blackman, J., dissenting).

87. *Id.* at 1927-29.

88. See generally *Hinds v. Mutual Life Ins. Co.*, 155 Me. 349, 155 A.2d 721 (1959) (presumptions); Fornoff, *Presumptions: The Proposed Federal Rules of Evidence*, 24 ARK. L. REV. 401 (1971); McNaughton, *Burden of Production of Evidence: A Function of a Burden of Persuasion*, 68 HARV. L. REV. 1382 (1955).

89. Ruder, *Challenging Corporate Action under Rule 10b-5*, 25 BUS. LAW. 75, 76 (1969).

90. 95 S. Ct. at 1930.

91. *Id.* at 1929.

92. 418 U.S. 323 (1974) (Supreme Court refashioned the damage rules in defamation cases).

facing the issue in the hundreds of reported cases presenting this question over the past quarter century have reaffirmed *Birnbaum's* conclusion."<sup>93</sup> Yet a close examination of the cases leads to the conclusion that courts have struggled to expand the plaintiff class for 10(b) and 10b-5 actions to meet the complex and fraudulent schemes appearing in corporate transactions.<sup>94</sup> Although most courts have achieved this result within the context of the purchaser-seller limitation, the strained interpretations that have denominated certain transactions as purchases or sales and certain plaintiffs as purchasers or sellers only serve to emphasize the necessity for a reexamination of *Birnbaum's* viability.<sup>95</sup> Bromberg, a noted commentator, after surveying the last two decades of securities litigation, has concluded that the buyer-seller requirement has been significantly "whittled away."<sup>96</sup>

A direct consequence of these decisions has been the appearance of a schism among the circuit courts, the SEC and members of the corporate bar. It has manifested itself in the following areas: (1) sale of control; (2) definitions of purchase and sale; (3) injunction suits; (4) expansion of the meaning of the "in connection with" requirement of 10(b) and 10b-5; (5) the causation-injury substitute; and (6) qualifications and inconsistencies.<sup>97</sup>

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93. 95 S. Ct. at 1923.

94. This goal has led one appellate court to declare:

In deciding whether a plaintiff has standing, we search for what will best accomplish the congressional purpose . . . . Thus we construe the "in connection with the purchase or sale of any security" clause found in both the section and the rule broadly and flexibly to effectuate that purpose . . . . The "purchaser"- "seller" standing requirement is to be similarly construed . . . so that the broad design of the section and the rule is not frustrated by the use of novel or atypical transactions.

*Herpich v. Wallace*, 430 F.2d 792, 806-07 (5th Cir. 1970).

95. There is nothing unique in this conclusion; in fact, much of this writer's research covers terrain which has been traversed many times before. See, e.g., Froelich & Spiegel, *supra* note 30; Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968); Comment, *Dumping Birnbaum*, *supra* note 60; Comment, *Purchaser-Seller Requirement Reevaluated*, *supra* note 53; Comment, *The Decline of the Purchaser-Seller Requirement of Rule 10b-5*, 14 VILL. L. REV. 499 (1969); Comment, *supra* note 58; Note, *Chipping Away at the Birnbaum Doctrine: Manor Drug Store v. Blue Chip Stamps*, 8 LOYOLA (L.A.) L. REV. 171 (1975); Note, *Limiting the Plaintiff Class: Rule 10b-5 and the Federal Securities Code*, 72 MICH. L. REV. 1398 (1974); Note, *Standing to Sue: Eason v. GMAC*, *supra* note 60; Note, *supra* note 58.

96. 2 BROMBERG §8.8 (Supp. 1968).

97. In order to facilitate analysis and trace the evolution of 10b-5 standing requirements, several commentators have chosen to categorize the cases adjudicated under 10b-5. See, e.g., Boone & McGowan, *supra* note 29; Ruder, *supra* note 57; Whittaker, *supra* note 53.



### 1. Sale of Control

Because the *Birnbaum* case has been generally acknowledged as a "sale of control" case, courts have often held that the mere sale of control for a premium, without more, is not cognizable under 10b-5.<sup>98</sup> Nevertheless, the "sale of control" cases do not constitute a monolithic approach resulting in a denial of 10b-5 actions, and the courts have granted relief in appropriate cases.<sup>99</sup> *Bogges v. Hogan*,<sup>100</sup> an obvious departure from *Birnbaum*, is instructive of the manner in which the strict purchaser-seller requirement has been ignored by the courts. The case involved a sale of control at a premium, a subsequent public tender offer at a lower price and also looting or waste of the corporate assets.<sup>101</sup>

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98. See, e.g., *Smith v. Murchison*, 310 F. Supp. 1079 (S.D.N.Y. 1970), in which the plaintiff sued derivatively and representatively on behalf of the corporation and shareholders to recover the alleged premium (over seven million dollars above the prevailing market price) received from the sale of 1.5 million shares of Alleghany common stock to Gamble-Skogmo. The court held that on these facts alone, there was not a claim upon which relief could be granted under 10b-5. *Accord*, *Erling v. Powell*, 429 F.2d 795 (8th Cir. 1970); *Christophides v. Porco*, 289 F.Supp. 403 (S.D.N.Y. 1968).

99. See, e.g., *Ferraioli v. Cantor*, 281 F.Supp. 354 (S.D.N.Y. 1967), in which the plaintiff contended that the defendants offered some stockholders of General Baking the opportunity to sell their stock at a premium, but further alleged that no such offer was made to him or the other shareholders whom he was representing. Additionally, no disclosure of the negotiation regarding the sale of control was made to the plaintiff or members of the class. The court held:

It is not necessary for the court to reach the question of whether a controlling stockholder violates Section 10(b) and Rule 10b-5 when he sells his control stock at a premium without notifying any of the other stockholders. It is sufficient here to hold that where a control stockholder invites some but not other stockholders to participate in the sale, a claim may be stated.

*Id.* at 357. There was no problem regarding the standing requirement in this case because plaintiff had sold his shares, but not at a premium. The larger problem, however, is reconciling this case with *Birnbaum*. *Birnbaum* involved substantially similar facts, including the accusation of a failure on the part of the defendants to disclose the premium at which the stock was being acquired. More importantly, however, the rationale of this case would be applicable even if the shareholders had not sold, for the injury sustained, that is, the difference in price between the prevailing market value and the premium received would be the same. *But see* *Haberman v. Murchison*, 331 F. Supp. 180 (S.D.N.Y. 1971), in which the court refused to follow the *Cantor* decision.

100. 328 F. Supp. 1048 (N.D. Ill. 1971).

101. The suit brought derivatively and representatively by the minority shareholders of plaintiff corporation, alleged that the corporate defendant, which had acquired a majority interest in the plaintiff corporation, had failed to disclose that "insiders" in the acquired corporation were secretly offered a premium to breach their fiduciary duties in regard to the subsequent tender offer. Plaintiffs further alleged that the defendant failed to reveal its plans to exploit the business and assets of the acquired corporation.

This case is also interesting because it focuses on problems involving a tender offer.

The gravamen of the complaint was an injury to the corporation and its shareholders through a fraudulent substitution of shareholder status in one company for the same status in another company. None of the members of the plaintiff class had actually sold their stock pursuant to the tender offer; rather, they had acquired shares in the new corporate entity in exchange for their original stock. However, relying on the seventh circuit's only "nominal recognition of the *Birnbaum* rule,"<sup>102</sup> the court found no reason to resolve the dispute as to the existence of a sale.<sup>103</sup> Therefore, this complaint was sufficient to recognize a meritorious claim under section 10(b) and rule 10b-5.<sup>104</sup> The outcome of this case, nevertheless, would appear to meet with the approval of the majority in *Blue Chip Stamps*, which recognizes derivative suits as a traditional exemption from the *Birnbaum* doctrine.<sup>105</sup> The plaintiff in a derivative suit need not be a purchaser or seller in the securities transaction; a shareholder may sue derivatively whenever the corporation has engaged in a securities transaction with a party whose conduct is proscribed by the rule.<sup>106</sup>

## 2. Definition of Purchase and Sale

To effectuate the broad remedial purposes of the section and the rule, the courts have expanded the definitions of purchase and sale.<sup>107</sup> In the

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One commentator has noted that the rise to popularity of the tender offer was the greatest strain upon *Birnbaum*. Whittaker, *supra* note 53, at 544. Until the Williams Act, Securities Exchange Act of 1934, §§13 (d)-(e), 14(d)-(f), 15 U.S.C. §§78m(d)-(e), 78n(d)-(f) (1970), was passed in 1968, rule 10b-5 was the only federal law regulating the tender offer. The purpose of the act is to proscribe fraud in connection with tender offers. For two novel cases involving tender offers that were litigated under 10b-5 see *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970); *Neuman v. Electronic Speciality Corp.*, CCH FED. SEC. L. REP., ¶ 92,591 (N.D. Ill. 1969).

102. 328 F. Supp. at 1051.

103. *Id.* See also notes 122-24 and accompanying text *infra* for a discussion of "forced sale".

104. 328 F. Supp. at 1053. *Contra*, *Erling v. Powell*, 429 F.2d 795 (8th Cir. 1970); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952); *Christophides v. Porco*, 289 F. Supp. 403 (S.D.N.Y. 1968). Nevertheless, the outcome in this case would appear to meet with the approval of the majority in *Blue Chip Stamps*, which recognizes two of the three general classes of plaintiffs traditionally barred by the *Birnbaum* doctrine.

105. 95 S. Ct. at 1926. See note 128 and accompanying text *infra*.

106. See, e.g., *Shell v. Hensley*, 430 F. 2d 819 (5th Cir. 1970); *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970); *Rekant v. Dresser*, 425 F.2d 872 (5th Cir. 1970); *Shoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, *Manley v. Shoenbaum*, 395 U.S. 906 (1969).

107. The statutory definitions of purchase and sale include contracts to purchase and

leading case of *Hooper v. Mountain State Securities Corporation*,<sup>108</sup> the action was brought by a trustee in bankruptcy seeking relief for the corporation which was misled by fraud, causing it to issue its stock in return for "spurious assets." The court held that this transaction constituted a sale within the meaning of section 10(b) and rule 10b-5, permitting the trustee of the defrauded corporation to maintain this action as a seller.<sup>109</sup> In this case, as well as in other cases,<sup>110</sup> the courts have demonstrated an inclination to accommodate various transactions within the purview of the statutory definitions of purchase and sale.

### 3. Injunction Suits

Courts have often avoided the strict purchaser-seller limitation in instances where the plaintiff sought injunctive relief.<sup>111</sup> Implicit in these

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sell. Securities Exchange Act of 1934, §§3(a)(13)-(14), 15 U.S.C. §§78c(a)(13)-(14) (1970).

108. 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961). *See also* SEC v. National Sec. Inc., 393 U.S. 453 (1969) (mergers); *Dudley v. Southeastern Factor and Fin. Corp.*, 446 F.2d 303 (5th Cir. 1971), *cert. denied*, 404 U.S. 858 (1971) (liquidations); *Rekant v. Dresser*, 425 F.2d 872 (5th Cir. 1970) (issuance of promissory note); *Movielab Inc. v. Berkey Photo Inc.*, 321 F. Supp. 806 (S.D.N.Y. 1970), *aff'd per curiam*, 452 F.2d 662 (2d Cir. 1971) (notes); *Fidelis Corp. v. Litton Indus. Inc.*, 293 F. Supp. 164 (S.D.N.Y. 1968) (corporate sale of assets and shares received in exchange); *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951). *But cf.* *Nanfito v. Tekseed Hybrid Co.*, 341 F. Supp. 234 (D. Neb. 1972) (merger).

109. 282 F.2d at 203, 205. *Accord*, *Schoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969); *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964).

110. *See* cases cited in note 108, *supra*.

111. The principal case in this area is *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540 (2d Cir. 1967). Plaintiff sued defendant corporation which had made a tender offer for Kress Corporation stock. The alleged 10b-5 violation arose out of the defendant's failure to disclose, in the tender offer, the true value of the Kress real estate holdings and the plan to sell, for an inadequate consideration, this real estate to Genesco's pension fund. This sale of real estate enabled the defendant to raise the funds needed to pay for the stocks acquired, thereby financing the acquisition of the Kress stock with Kress's own assets. It was further alleged that the defendant, after gaining a controlling interest in Kress, manipulated the price of the stock with a view towards persuading other Kress stockholders to sell to the defendant. The court found the causal connection between the fraud in the tender offer and an injury to plaintiff slim because plaintiffs had purchased their stock after the alleged deceptions involved in the tender offer and therefore the court denied a suit for damages on this count. *But cf.* *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972) (assessable damages); *Voegel v. American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965) (sufficient causal connection). Nevertheless, plaintiff was permitted to maintain a suit for injunctive relief in connection with the stock manipulation which occurred after plaintiff had purchased its stock. The fact that plaintiff was simply a shareholder, and neither a purchaser nor a seller as a result of the defendant's manipulation of the Kress stock, was not controlling in a claim for injunctive

proceedings are private attorneys general who supplement the enforcement powers granted the SEC.<sup>112</sup> Private enforcement is essential because the opportunity for fraud in the securities community is greater than the capacity of the Justice Department and the SEC to police and prevent it. More importantly, these injunctions protect the potential investor by halting the proscribed conduct prior to its occurrence. This is consistent with one purpose of the securities law; namely, to protect the investing public, including corporations, from transactions and machinations conceived with a fraudulent purpose.<sup>113</sup>

#### 4. *Expansion of the Meaning of the "in connection with" Requirement of 10(b) and 10b-5*

Courts have given novel interpretations to section 10(b) and rule 10b-5 in discerning the requisite connection between the alleged injury and a securities transaction. One of the most novel and expansive definitions to date comes from the case of *Voege v. American Sumatra Tobacco Corp.*<sup>114</sup> This case demonstrates that the mere purchase of stock in a corporation, irrespective of its proximity in time to or consequence of any 10(b) or 10b-5 violation, may meet the requirement of a nexus between the injury and the purchase or sale of a security.<sup>115</sup> A fully

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relief because these claims largely avoid issues of injury and causation, cure a continuing harm suffered by shareholders who hold their stock, and provide relief from future violations of the rule. 384 F.2d at 547.

112. Securities Exchange Act of 1934, §21(e), 15 U.S.C. §78u(e) (1970). The Supreme Court in *Blue Chip Stamps* noted that the purchaser-seller requirement does not affect the SEC's standing in seeking injunctive relief under section 10(b) and rule 10b-5. On the other hand, the Court is conspicuously silent as to private injunctive actions, thereby casting doubt upon the validity of this remedial route for violation of the securities laws. 95 S. Ct. at 1933 n.14.

113. *See also* SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77 (S.D.N.Y. 1970) (equitable relief includes the power to require "insiders" to relinquish the profit made as a result of their trading on inside information); *Federal Sav. & Loan Ins. Corp. v. Fielding*, 309 F. Supp. 1146 (D. Nev. 1969) (a non-purchaser-seller entitled to injunctive equitable relief is also entitled to the equitable relief on an accounting).

114. 241 F. Supp. 369 (D. Del. 1965). Plaintiff, suing individually, representatively, and derivatively, alleged violation of 10b-5 as a consequence of a series of transactions which culminated in a merger requiring minority shareholders, including plaintiff, to surrender their stock at a price beneath its real value. This merger was brought about by two corporations which held a controlling interest in the target company in an attempt to appropriate the assets to themselves. The plaintiff neither sold her shares nor elected to accept the \$17 per share in lieu of securities or other consideration. She demanded an appraisal pursuant to state law but took no further action thereon. The court held that the plaintiff was a seller; the "forced sale" in these circumstances was sufficient to satisfy the seller requirement.

115. The court expanded the meaning of the "in connection with the purchase of sale

developed federal law of fiduciary responsibility to securities investors may be postulated as a consequence of the extensive corporate liability imposed by *Voege*. Given the federal courts' authority to fashion remedies when federal rights are involved<sup>116</sup> and a federal law of fiduciary responsibility, a concomitant decline of the traditional state responsibility in the area of corporate mismanagement is foreseeable.<sup>117</sup>

### 5. *The Causation-Injury Substitute for Birnbaum*

In the leading case of *Eason v. General Motors Acceptance Corp.*,<sup>118</sup> the seventh circuit rejected the strict purchaser-seller limitation of *Birnbaum* and instead relied upon a causation-injury test for defining the plaintiff class under section 10(b) and rule 10b-5. The court, in

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of any security" requirement when it determined that the plaintiff, in purchasing her stock twenty years earlier, had relied upon the honesty and fair dealing of the company.

Plaintiff necessarily relied upon this all important condition when, by acquiring her shares, she agreed . . . that Old Company could be merged upon terms later to be determined. Plaintiff . . . was the subject of deception for when she acquired her stock she did so upon the justifiable assumption that any merger would deal with her fairly, only later to find . . . that the terms of the merger were designed to defraud her.

*Id.* at 375.

116. See *Kardon v. National Gypsum Corp.*, 69 F. Supp. 512 (E.D. Pa. 1946), notes 10-11 and accompanying text *supra*. See also *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448 (1957); *Bivens v. Six Unknown Named Agents of the Federal Bureau of Narcotics*, 403 U.S. 388 (1971).

117. It is this writer's contention that, even with an expanded class of plaintiffs permitted in 10b-5 actions, a harmonious balance may be maintained in our federal system. See note 126, *infra*.

118. 490 F.2d 654 (7th Cir. 1973). Plaintiffs were shareholders of a corporation which purchased a car leasing business from defendants. The corporate purchaser issued shares of its stock to the seller, and the plaintiffs individually guaranteed certain liabilities assumed by the corporate purchaser. The business failed, and the purchasing corporation became insolvent and defaulted upon the notes. The basis of the 10b-5 complaint was that defendants made various misrepresentations and omissions regarding the viability of the business. The defendants conceded violation of 10b-5, but maintained that plaintiffs lacked standing to assert the 10b-5 claim. The court briefly examined principles of standing, the course of the decisions since *Birnbaum*, and concluded:

The emphasis on the injured party's status as an investor indicates that the protection of the rule extends to persons who, in their capacity as investors, suffer significant injury as a direct consequence of fraud in connection with a securities transaction, even though their participation in the transaction did not involve either the purchase or sale of a security.

*Id.* at 659. See also *Vincent v. Moench*, 473 F.2d 430, 435 (10th Cir. 1973); *Young v. Seaboard Corp.*, 360 F. Supp. 490, 494-95 (D. Utah 1973); *Tully v. Mott Supermarkets, Inc.* 337 F. Supp. 834, 841 (D.N.J. 1972); *Commerce Reporting Co. v. Puretec*, 290 F. Supp. 715, 719 (S.D.N.Y. 1968); Comment, *supra* note 60; Note, *supra* note 60.

focusing on the issue of standing, found it more useful to determine whether plaintiffs were members of the class for whose special benefit 10b-5 existed. Its examination of the statutes, case law, and SEC policy led it to conclude that the class of persons protected consisted of those persons who were injured in their capacity as investors. The plaintiff in *Eason* merely needed to prove that the injury was directly caused by a fraud in connection with the purchase or sale of a security.<sup>119</sup>

The causation-injury approach can be seen as an appropriate substitute for the *Birnbaum* limitation. The primary justification for the *Birnbaum* rule is that it allegedly permits a precise determination of plaintiff's injury thus avoiding hypothetical or speculative recovery. The causation-injury approach still requires proof of injury as a direct consequence of the fraud.<sup>120</sup> More important, the presence of the fraud becomes the *sine qua non* of the right to sue,<sup>121</sup> freeing the courts from becoming mired in technical questions of standing and enabling them to define appropriate damage rules on an ad hoc basis.

### 6. *Qualifications and Inconsistencies*

The other instances in which courts have shown reluctance to adhere to *Birnbaum* have been collected under the rubric of "qualifications and inconsistencies." The most cited and accepted qualification is the "forced seller" concept.<sup>122</sup> An interesting example is provided by *Crane Co. v. Westinghouse Air Brake Co.*,<sup>123</sup> where plaintiff's tender offer was defeated when its competitor acquired the target company, merged with

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119. 490 F.2d at 659. The Supreme Court rejected the causation-injury approach in *Blue Chip Stamps*, 95 S. Ct. at 1926 n.8.

120. As in *Blue Chip Stamps*, each case must stand upon its own facts; however, the requirement of "actual damages" is satisfied when there is evidence sufficient upon the record enabling the trier of fact to make a reasonable inference. For a discussion of the kinds of evidence from which reasonable inferences can be made, see notes 71-77 and accompanying text *supra*.

121. Lowenfels, *supra* note 95, at 276.

122. See, e.g., *Coffee v. Permian Corp.*, 306 F. Supp. 1371 (N.D. Tex. 1969), *aff'd*, 474 F.2d 1040 (5th Cir.), *cert. denied*, 412 U.S. 920 (1973); *Dudley v. Southeastern Factor & Fin. Corp.*, 446 F.2d 303 (5th Cir.), *cert. denied*, 404 U.S. 858 (1971); *Vine v. Beneficial Fin. Corp.*, 374 F.2d 627 (2d Cir. 1967). -

123. 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970). Plaintiff Crane made a tender offer for shares of Westinghouse Air Brake Co. Air Brake, in a move to defeat the tender offer, began merger negotiations with Crane's major competitor, Standard. Standard purchased and sold large blocks of Air Brake, thereby manipulating the market, driving up the price of the stock, and defeating the tender offer. Upon successful completion of the merger, it appeared that Crane owned 32% of the outstanding stock. Crane was subsequently forced to sell under threat of an antitrust divestiture action instigated by Standard. The court concluded that Crane was a "forced seller."

it and thereby forced Crane to sell its acquired stock. The perplexing aspect of the case arises from the fact that standing was conferred on a "forced seller" basis. This transaction did not result in injury; rather, the efforts of Standard in the manipulation of the market caused Crane, which had purchased "low," to realize a profit of several million dollars. In short, there was no injury "in connection with" the securities transaction. This decision, as so many others, serves to demonstrate the strained interpretations in which courts will engage when attempting to provide remedies for conduct proscribed in section 10(b) and rule 10b-5 and still comply with the purchaser-seller requirement.<sup>124</sup>

The cases concerning unconsummated transactions tainted by fraud pose the most serious challenge to the *Birnbaum* doctrine.<sup>125</sup> In these cases the decision to forego a purchase or sale is a decision formed on the basis of existing information. A principal purpose of the securities laws has been to inform the investor and protect him from schemes designed to defraud the careless and the uninformed. The *Birnbaum* limitation leaves unremedied the victims of successful frauds directed at deterring the purchase or sale of securities. To these victims, the *Blue*

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124. Loss, commenting upon a similar transaction in *Vine v. Beneficial Fin. Corp.*, 374 F.2d 627 (2d Cir. 1967), noted:

Any deception in that case was in connection with an earlier stock acquisition from the great bulk of plaintiff's fellow stockholders—a deception that did not relate to the plaintiff, who never sold in the usual sense. The court's answer to this contention—that it "ignores the simple fact that the plaintiff would never be in a position of a forced seller were it not for the fraud"—does somewhat shake the traditional view that only a defrauded buyer or seller can sue only the person who defrauded him.

6 L. Loss, *supra* note 60, at 3623.

125. The doctrine has witnessed substantial erosion in this area. Some courts have held that an investor is granted a private action in some instances where he has been misled not to sell his securities. *See, e.g.*, *Goodman v. H. Hentz & Co.*, 265 F. Supp. 440 (N.D. Ill. 1967); *Opper v. Hancock Sec. Corp.*, 250 F. Supp. 668 (S.D.N.Y.), *aff'd*, 367 F.2d 157 (2d Cir. 1966); *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965). Some courts have likewise recognized that a party to a contract to purchase or sell is a purchaser or seller and may sue if the contract is not performed. *See, e.g.*, *Richardson v. MacArthur*, 451 F.2d 35 (10th Cir. 1971); *Allico Nat'l Corp. v. Amalgamated Meat Cutters*, 397 F.2d 727 (7th Cir. 1968); *A. T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715 (S.D.N.Y. 1968). Similarly, some courts have recognized the "aborted seller-purchaser" doctrine, in which the factual circumstances disclosed well-defined opportunities for a securities transaction. *See, e.g.*, *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515 (8th Cir. 1973); *Fenstermacher v. Philadelphia Nat'l Bank*, 351 F. Supp. 105 (E.D. Pa. 1972), *aff'd*, 493 F.2d 333 (3d Cir. 1974). *Contra*, *Mount Clemens Indus., Inc. v. Bell*, 464 F.2d 339 (9th Cir. 1972). *See also* note 122 and accompanying text *supra*. Some courts have even acknowledged the equitable owners as purchasers or sellers. *See, e.g.*, *James v. Gerber Prod. Co.*, 483 F.2d 944 (6th Cir. 1973) (trust beneficiary); *Dopp v. Franklin Nat'l Bank*, 461 F.2d 873 (2d Cir. 1972) (foreclosed pledgor).

*Chip Stamps* majority's recognition of the *Birnbaum* disadvantages can only be "cold comfort." Nor is there much comfort to be derived from the Court's opinion that these disadvantages are mitigated by the existence of remedies under state law.<sup>126</sup>

This brief survey of the litigation brought under the section and the rule was not meant to compel a conclusion that the *Birnbaum* doctrine was without force in the United States courts.<sup>127</sup> Courts are at odds as to the scope of the doctrine. They have ingeniously circumvented its application and on occasion disavowed it. So viewed, it may be concluded that the purchaser-seller requirement has long outlived its usefulness as a limiting doctrine in defining the perimeters of actions brought under the section and the rule. An increase in the complexity and sophistication of fraud arising in securities transactions has necessitated the gradual disappearance of other limiting doctrines. For these same reasons, the *Birnbaum* doctrine is no longer an appropriate vehicle for defining the limits of the plaintiff class in 10(b) and 10b-5 actions. The decision in *Blue Chip Stamps*, by injecting the doctrine with new vitality, maintains arbitrary and artificial limits upon the plaintiff class. As such, it denies access to a federal forum to those very persons injured as a result of fraud in connection with a securities transaction.

#### THE IMPACT OF *Blue Chip Stamps*

The consequences of the *Blue Chip Stamps* decision are manifold. The holding directs the district courts to mechanically apply the purchaser-seller requirement without considering the defendant's culpa-

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126. 95 S. Ct. at 1927 n.9. The reliance upon state law remedies is often insubstantial. A survey of the state corporate laws will reveal different orientations. For example, Delaware is oriented towards management; California is oriented towards the shareholder. Most states probably fall in between these extremes. Consequently, protection for the shareholder or investor varies from state to state, with uncertainty of protection being the norm. See Folk, *Corporation Statutes: 1959-1966*, DUKE L.J. 875 (1966). Professor Ruder has concluded that a federal corporate law is therefore desirable:

Given the relative lack of shareholder protection in Delaware, the state where certainty of result is the greatest, and the relative uncertainty of result in other states, federal corporation law becomes an attractive alternative. Choice of federal law also reflects the fact that most corporations of moderate or large size are owned by shareholders who reside in all parts of the nation.

Ruder, *supra* note 57, at 1291-92.

127. See, e.g., *Sargent v. Genesco, Inc.*, 492 F.2d 750 (5th Cir. 1974); *Landy v. F.D.I.C.*, 486 F.2d 139 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *Mount Clemens Indus., Inc. v. Bell*, 464 F.2d 339 (9th Cir. 1972); *Simmons v. Wolfson*, 428 F.2d 455 (6th Cir. 1970), *cert. denied*, 400 U.S. 999 (1971); *City Nat'l Bank v. Vanderboom*, 422 F.2d 221 (8th Cir.), *cert. denied*, 399 U.S. 905 (1970); *Iroquois Indus., Inc. v. Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970).



bility or the plaintiff's capacity to prevail on the merits. Nevertheless, those district courts sensitive to meritorious claims from deserving plaintiffs will continue to avoid its application by resorting to judicial legerdemain or by contriving new exceptions.

By specifically endorsing the *Birnbaum* decision, the *Blue Chip Stamps* holding limits the plaintiff class in 10(b) and 10b-5 actions to actual purchasers and sellers. A closer examination of the opinion reveals that the Supreme Court, in deference to the decided case law of the last two decades, recognized two important exceptions to the *Birnbaum* rule: (1) derivative actions by shareholders who have neither purchased nor sold securities;<sup>128</sup> and (2) actions by those parties holding contractual obligations and rights to purchase or sell securities, who were prevented from engaging in a consummated securities transaction due to an intervening fraud.<sup>129</sup>

There is no specific language in *Blue Chip Stamps* which may be cited as affecting those cases decided under the rubrics of "definition of purchase and sale," "forced seller," and "aborted purchaser" doctrines. Nevertheless, several conclusions are possible. The Exchange Act of 1934 includes contractual rights within the definition of purchase<sup>130</sup> and sale,<sup>131</sup> and the Supreme Court has generally shown itself receptive to an expansive definition of what constitutes a purchase or sale.<sup>132</sup> The case of the "forced seller" presents a somewhat more difficult assessment. The Supreme Court has never had occasion to rule upon such a situation. Although a recognition of the "forced seller" concept would be consistent with a broad definition of purchase and sale, the Court's apparent hostility in *Blue Chip Stamps* to individual or representative suits, except in the clearest of cases involving a purchase or sale, leads to the conclusion that future litigation by a "forced seller" should be based upon a derivative claim. Similarly, the Supreme Court has not had any occasion to rule upon an action based upon an aborted transaction. In those circumstances where contractual rights are disclosed, plaintiffs are upon safe ground. On the other hand, a literal acceptance of *Blue Chip Stamps* compels the conclusion that the Court will recognize the aborted seller only under circumstances where the shareholder sues derivatively.

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128. 95 S. Ct. at 1926. Because the reaffirmation of *Birnbaum* extends only to the standing requirements, it would be safe to say that the courts would not hesitate to entertain a derivative action arising in a similar factual context.

129. *Id.* at 1932.

130. Securities Exchange Act of 1934, § 3(a)(13), 15 U.S.C. § 78c(a)(13) (1970).

131. *Id.* § 3(a)(14), 15 U.S.C. § 78c(a)(14).

132. *See, e.g.,* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971); SEC v. Nat'l Sec., Inc., 393 U.S. 453 (1969).

The Supreme Court in *Blue Chip Stamps*, specifically rejected the causation-injury approach.<sup>133</sup> Thus, past cases decided under a causation-injury theory, unless otherwise maintainable, are of suspect precedential value.

Those plaintiffs who sue on the theory that an intervening fraud caused them not to purchase stock will be denied standing to litigate under 10(b) and 10b-5. The opinion in *Blue Chip Stamps* thus presents a contradictory position. That is, it would permit suits by would be sellers of stock, who, because of the fraud, hold their stock; but, deny standing to a would be purchaser of stock. The ground for denial in the latter situation is that the determination of damages is too speculative.<sup>134</sup> Surely, the former situation may arise in equally speculative circumstances—namely, would the stockholder have sold, and, if so, how many shares and at what point in time. Nevertheless, this degree of speculation has not deterred the courts from determining damages in cases such as *Myzel v. Fields*<sup>135</sup> and *Affiliated Ute Citizens of Utah v. United States*.<sup>136</sup>

As is true of most decisions, *Blue Chip Stamps* leaves more questions unanswered than answered. Inasmuch as the decision does not specifically include injunctive suits as an exception to the *Birnbaum* rule,<sup>137</sup> it leaves doubt as to whether they remain an exception to the purchaser-seller limitation. Even though the opinion allows circumvention of the actual purchaser-seller requirement in derivative actions and in cases of clearly defined opportunities for purchase or sale in instances when contractual rights and duties exist, it leaves unanswered questions regarding which actions are cognizable as derivative or contractual. Although it allows derivative actions to be maintained, it would seem to cast doubt upon these same actions if they were brought by someone in an individual or representative capacity. This problem can only lead to the twin consequences postulated earlier—mechanical application or circumvention of the purchaser-seller requirement. The end result will be another era of judicial decisions fraught with all the vices which the Supreme Court is expected to curtail; namely, forum shopping in those circuits most sympathetic to 10b-5 claims and a conflict among the circuits as to the vitality of the purchaser-seller requirement.

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133. 95 S. Ct. at 1926 n.8.

134. *Id.* at 1925. See notes 68-69 and accompanying text *supra*.

135. 386 F.2d 718 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968). See note 72, *supra*.

136. 406 U.S. 128 (1972). See note 71, *supra*.

137. See note 112, *supra*.

## CONCLUSIONS

Section 10(b) and rule 10b-5 are the most litigated provisions of the federal securities laws. The decision in *Blue Chip Stamps* will not serve to check the amount of litigation brought under these provisions. To this writer, it appears that an unspoken reason for reaffirming *Birnbaum* is a concern for the federal structure.<sup>138</sup> One commentator refers to this as an inability to reconcile the twin goals of "investor protection" and "federal integrity."<sup>139</sup> But surely, the sheer volume of litigation brought under 10b-5 is sufficient evidence to rebut the assertion of adequate state protection in this regard.<sup>140</sup>

The SEC response to the threat of "vexatiousness" and social cost is also instructive and is worthy of quoting at length:

The existing exceptions to the *Birnbaum* rule allow some individuals who neither purchased nor sold securities to bring suit, and so already permit the vexatious litigation petitioners fear. Others may sue in the hope of creating additional exceptions to the rule. Litigation over these exceptions can be protracted and costly, as the instant case demonstrates. Indeed, the combined social costs of strike suits falling within the current exceptions and the costs of litigation determining the existence and scope of these exceptions may exceed whatever costs might be incurred from allowing standing to all persons within the class protected by Rule 10b-5 who allege they have been injured by a defendant's violation of it.<sup>141</sup>

The twenty-four years from *Birnbaum* to *Blue Chip Stamps* lend themselves to several observations. The task of defining the limits of 10(b) has been left to the courts to fashion doctrine on an ad hoc basis. This is unfortunate, for this task properly devolved upon the SEC. Yet, the SEC has chosen not to exercise its prerogative. Instead, the Commission has been content to assume a passive role as *amicus curiae*. Because the Commission is a body with the essential expertise and extensive rule-making authority, it is better suited than the courts to

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138. The present Supreme Court has generally shown itself to be solicitous towards the role of the states in the federal system. See, e.g., *Hicks v. Miranda*, 95 S. Ct. 2281 (1975); *Huffman v. Pursue, Ltd.*, 95 S. Ct. 1200 (1975).

139. Note, *supra* note 60, at 1148.

140. The injured investor is more likely to base his claim upon a violation of section 10(b) and rule 10b-5 rather than upon state remedial provisions. One reason for this preference lies in the advantages afforded by the Federal Rules of Civil Procedure. See 3 BROMBERG § 11.2-11.4 (Supp. 1974). Another reason involves the inadequacy of the laws of many states to protect the investing public. See note 126, *supra*.

141. Brief for SEC as *Amicus Curiae* at 32, *Blue Chip Stamps v. Manor Drug Stores*, 95 S. Ct. 1917 (1975).

promulgate rules and regulations regarding section 10(b), and it should instead leave to the courts their proper role of interpretation.

Inasmuch as the position of the SEC, as gleaned from their frequent *amicus curiae* appearances, indicates a decided preference for the causation-injury approach, the courts should properly defer such a judgment to the administrative body charged with enforcement of the securities laws. Since causation and injury are the key elements in every 10b-5 case,<sup>142</sup> this approach is the one most consistent with the remedial and prophylactic purposes of the securities laws in general and the language of the section and the rule in particular. Although there exists fear that this approach is too open-ended, and leads to speculative recovery and substantial damages, this fear can be allayed by strict standards of proof using materiality and reliance as guidelines. Courts can require that the fraud "touch" a securities transaction,<sup>143</sup> and further require that the plaintiffs be within the class of persons who the section and the rule were designed to protect. As was pointed out in *Affiliated Ute Citizens of Utah v. United States*,<sup>144</sup> damages are not speculative where there is sufficient evidence in the record from which reasonable inferences may be made as to "actual damages." That case also established that a causal connection between the wrongful omission and the injury may be presumed if the omission relates to facts to which a reasonable investor would have attached significance. This presumption is particularly applicable in cases involving potential investors, who because of a successful fraud, neither purchased nor sold securities. In instances where the relationship between the parties will not support such a presumption, such as the absence of a face-to-face transaction, the plaintiff must present evidence, independent of oral testimony, of a nexus between the alleged proscribed conduct and the alleged injury.

Finally, in an effort to avoid strike and nuisance suits, it is suggested that a provision similar to section 11(e) of the 1933 Act<sup>145</sup> be added to the 1934 Act. This should provide an adequate deterrent to the filing of unmeritorious claims.<sup>146</sup> The costs of instituting federal litigation are substantial, a factor partially attributable to the liberal provisions of the

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142. See notes 118-21 and accompanying text *supra*.

143. See, e.g., *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12-13 (1971).

144. 406 U.S. 128 (1972). See note 71, *supra*.

145. 15 U.S.C. § 77k(e) (1970). See note 80, *supra*.

146. Such a statute should provide the court with broad discretion regarding the necessity for posting any security for litigation expenses. The criteria for determining this posting should focus upon whether the litigation was initiated in bad faith or is utterly without merit. See generally 1 BROMBERG § 2.5(2) (Supp. 1968).

Federal Rules of Civil Procedure. Faced with a very real threat of burdensome costs, potential plaintiffs would rarely hazard any vexatious litigation.

These modest suggestions, which focus upon the economic realities which inhere in securities transactions, permit the courts to focus upon the merits of 10b-5 claims instead of the mechanics of standing. Unfortunately, the Supreme Court in *Blue Chip Stamps* chose to become mired in the latter, and, in so doing, ignored its own wise counsel by engaging in "glib generalizations and unthinking abstractions."<sup>147</sup>

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147. SEC v. National Sec. Inc., 393 U.S. 453, 465 (1969).